FILE COPY

FILED
AUG 11 1949
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

No. 251

THE BALTIMORE AND OHIO RAILROAD COMPANY,
Petitioner,

vs.

M. HAMPTON MAGRUDER,
COLLECTOR OF INTERNAL REVENUE,
DISTRICT OF MARYLAND,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

JOHN S. STANLEY,
D. HEYWARD HAMILTON, JR.,
Counsel for Petitioner.

The Daily Record Co., Baltimore 3, Md.

INDEX

	PAGE
PETITION FOR WRIT	1-8
I. SUMMARY STATEMENT	1-5
II. STATUTES INVOLVED	6
III. JURISDICTIONAL STATEMENT	6
IV. QUESTION PRESENTED	7
V. REASONS RELIED ON FOR ALLOWANCE OF WRIT	7-8
BRIEF:	9-28
I. OPINIONS OF COURTS BELOW	9
II. JURISDICTION	9
III. STATEMENT OF THE CASE	9
IV. SPECIFICATION OF ERRORS	10
V. ARGUMENT	10-28
A. In holding that the fact of contest of a liability by suit is alone a sufficient manifestation of contingency, the Court of Appeals has misinterpreted *Dixie Pine Co. v. Commissioner* and *Security Flour Mills Co. v. Commissioner* and has failed to give proper effect to the principles of law established by this Court in the line of cases beginning with *United States v. Anderson*	10-24
B. The Court of Appeals has decided a question of importance in the administration of the Internal Revenue Law which has not been, but should be, settled by this Court	24-28
VI. CONCLUSION	28

CITATIONS

PAGE

Cases:

Aluminum Castings Co. v. Routzahn (282 U.S. 92) 20

Atlanta, B. and C. R. Co. v. Forrester (25 S.E. 581; 1943) 25

Brown v. Helvering (291 U.S. 193) 20

Burnet v. Sanford & B. Co. (282 U.S. 359) 25

Chicot County Drainage District v. Baxter State Bank et al. (308 U.S. 371) 16

Continental Tie & Lumber Co. v. U. S. (286 U.S. 290) 20

Dixie Pine Products Co. v. Commissioner (320 U.S. 516) 7, 9, 10, 11, 13

Dobson v. Helvering (320 U.S. 489) 14

Lucas v. American Code Co. (280 U.S. 445) 12, 18, 19, 20

Niles Bement Pond Co. v. United States (281 U.S. 357) 20

Security Flour Mills Co. v. Commissioner (321 U.S. 281) 7, 9, 10

U. S. v. Anderson (269 U.S. 422) 7, 9, 20, 27

Statutes:

Carriers' Taxing Act of 1935 (49 Stat. 974) 1, 2, 5, 7, 10, 13, 14, 15, 16

Carriers' Taxing Act of 1937 (50 Stat. 435) 3, 17

Joint Resolution No. 9 (50 Stat. 23) 2, 16

Revenue Act of 1936:

Section 23(a) 22, 23

Section 23(c) 6, 7, 10, 23, 24

Section 41 ..... 6, 7

Section 43 ..... 6, 7, 23

PAGE

Miscellaneous:

I. T. 3116 (C. B. 1937-2) 3-4, 5

Title 28, U. S. Code:

Section 1254(1) 6, 9

Section 2101(c) 6, 9

Supreme Court Rule 38 ..... 6, 9

IN THE

Supreme Court of the United States

No. ------

THE BALTIMORE AND OHIO RAILROAD COMPANY,
Petitioner,

VS.

M. HAMPTON MAGRUDER,
COLLECTOR OF INTERNAL REVENUE,
DISTRICT OF MARYLAND,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

TO THE HONORABLE FRED M. VINSON, CHIEF JUSTICE OF THE SUPREME COURT OF THE UNITED STATES, AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner respectfully shows:

I.

SUMMARY STATEMENT OF THE MATTER INVOLVED

The Carriers' Taxing Act of 1935 (c. 813, 74th Congress, 1st Session—Public Law No. 400; 49 Stat. 974) was approved on August 29, 1935, and became effective March 1, 1936. (R. 3, 26, 79, 110). Section 4 of this Act imposed on the Petitioner and other railroad companies an excise tax of 3½%

of the compensation, not in excess of $300.00 per month, paid to employees after the effective date (R. 79). By Section 12 this excise tax was to terminate on February 28, 1937. On January 6, 1936, one hundred and thirty-eight railroads, including the Petitioner and three of its subsidiaries, filed suit in the District Court for the District of Columbia attacking the constitutionality of this Taxing Act (R. 3, 110).

Beginning with the month of March, 1936, the Petitioner and four of its subsidiaries accrued on their books of account the excise tax so imposed upon them and continued to do so for each calendar month for the remainder of that year (R. 5, 13, 47, 48, 54, 55, 68, 80, 111). The Railroad Company had for some time kept its books on the accrual basis as prescribed by the Regulations of the Interstate Commerce Commission and filed its income tax returns on the same basis (R. 2, 26, 39, 45, 52, 68, 111). It filed no returns of the excise taxes due under the Taxing Act and paid no part of the taxes imposed upon it thereby (R. 14, 81, 111).

On June 26, 1936, the District Court held the Taxing Act unconstitutional (16 F. Supp. 955) (R. 3, 27, 79, 111). Four days later there was entered a final decree which, among other things, permanently enjoined the Commissioner of Internal Revenue from "demanding, collecting or attempting to collect any such amount from Plaintiffs" (R. 3, 79).

On July 17, 1936, the Defendants appealed to the Court of Appeals for the District of Columbia (R. 4, 27, 79).

By Joint Resolution No. 9, approved February 27, 1937 (c. 19. 1st Session, 75th Congress, 50 Stat. 23), Congress extended the effective period of the Carriers' Taxing Act of 1935 to June 30, 1938 (R. 3, 26-27, 79).

On or about March 15, 1937, the Petitioner filed its consolidated corporation income and excess profits tax return for the calendar year 1936, computed upon the accrual basis. This return showed a surtax net income and an undistributed profits tax thereon in the amount of $93,972.55, which was paid to the Collector during 1937. In computing this return the Petitioner deducted the Carriers' Excise Taxes imposed on it and its four subsidiaries for the period from March 1 to December 31, 1946, in the sum of $2,525,-986.36, which had been accrued on their books (R. 5, 12-13, 27-28, 82, 111).

On June 29, 1937, there was approved the Carriers' Taxing Act of 1937 (Public Law No. 174, c. 405, 1st Session, 75th Congress, 50 Stat. 435; Title 45 U.S.C.A. Secs. 261-273), which by Section 11 thereof was expressly stated to be in substitution for the provisions of the Taxing Act of 1935 which was thereby repealed. Section 11 also provided that "All moneys payable as and for taxes under such Act of August 29, 1935, and not heretofore paid shall cease to be payable and all proceedings pending for the recovery of any such moneys shall be terminated" (R. 4, 27, 79).

Pursuant to a Joint Motion to Reverse and Remand as Moot the District Court's decree of June 30, 1936, the Court of Appeals entered on July 2, 1937, a decree reversing the District Court and remanding the case with instructions to enter a final decree of dismissal because the controversy had become moot. On July 6, 1937, the District Court entered such a decree (R. 4, 5, 27, 79).

Under date of August 6, 1937, the Bureau of Internal Revenue issued its ruling, designated as I. T. 3116 (C. B. 1937-2, p. 90) reading, in part, as follows:

> "(a) In those cases in which the carriers' excise tax was paid by the carrier prior to the enactment of the

Carriers' Taxing Act of 1937, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will be allowed and refunds of such tax will be required to be included in the gross income of the carrier for the year in which the refund is made.

"(b) In those cases in which the carriers' excise tax was not paid to the collector and the carrier was not a party to the suit under the Carriers' Taxing Act of 1935, or did not otherwise contest liability for such tax, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will also be allowed and the amount of the tax will be included in the gross income of the carrier for the year in which the liability for the tax was extinguished, that is, for the calendar year 1937.

"(c) In those cases in which the carriers' excise tax was not paid to the collector and the carrier was a party to the suit under the Carriers' Taxing Act of 1935, or otherwise contested liability for such tax, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will be disallowed and no adjustment of the income tax return of the carrier for the calendar year 1937 will be made on account of the extinguishment of the carrier's liability for the tax" (R. 16, 17, 18, 80, 111-112).

On May 12, 1938, the Petitioner filed a claim for refund of the undistributed profits tax of $93,072.55, paid the Collector in 1937, on the ground that certain substantial deductions from gross income for the year 1936 should have been made and also that deductions for depreciation and for accruals of the Carriers' Excise Taxes should have been allowed. The effect of allowing the deductions for depreciation and for the accruals and the reductions in the gross income would have been to eliminate all liability for the undistributed profits tax so paid and thus to have entitled

the Petitioner to the allowance of the refund in full (R. 6, 11, 15-18, 28, 81, 111).

Pursuant to I. T. 3116 the Bureau of Internal Revenue disallowed the deduction for the accrual of the Carriers' Excise Taxes, except for the sum of $442.45 which was the amount of the accrual made by the Curtis Bay Railroad Company, a subsidiary of the Petitioner that was not a party to the carriers' suit attacking the constitutionality of the Taxing Act of 1935. The deduction of the accrual of $442.45 in taxes paid by this subsidiary was allowed by the Bureau (R. 6, 7, 11, 14, 22, 29). After making certain adjustments in the return in favor of the Petitioner, the Bureau re-computed the income tax with the result that a deficiency of $76,786.08 with interest was disclosed. (R. 7, 8, 20, 21, 23, 24). This sum with interest of $21,166.66, including $629.02 charged as a result of incorrect computation and subsequently refunded, was paid by the Petitioner subject to a reservation of its right to litigate the disallowance of the deduction for the Carriers' Excise Taxes in the amount of $2,525,543.91 (R. 7-8, 19, 29). The Petitioner's first and second claims for refund together with its amendatory claim in the amount of $190,396.27 were finally denied and on May 4, 1943, the complaint in this case was filed to recover the above total sum and interest (R. 8, 9, 18-19, 20-26, 29-30, 81, 112).

The United States District Court for the District of Maryland overruled Petitioner's motion for a summary judgment and granted a motion for judgment on the pleadings in favor of the Respondent and the Court of Appeals for the Fourth Circuit affirmed (R. 108, 115).

II.

STATUTES INVOLVED

The Statutes involved are as follows:

Section 23 (c) of the Revenue Act of 1936 (Chapter 690, 49 Stat. 1648, 1658-59):

> "In computing net income there shall be allowed as deductions:
>
> * * * * * *
>
> (c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, * * *."

Section 41 of said Act reading as follows:

> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *"

Section 43 of said Act reading as follows:

> "The deductions and credits provided for in this title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *"

III.

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is invoked under Title 28, United States Code, Sections 1254 (1) and 2101 (c) and Rule 38 of this Court.

IV.

QUESTION PRESENTED

The question presented is whether the Petitioner, an interstate carrier which kept its accounts on the accrual basis and in accordance with the uniform system of accounts prescribed by the Interstate Commerce Commission, was entitled, under Sections 23 (c), 41 and 43 of the Revenue Act of 1936 and under the facts disclosed by the record in this case, to deduct on its consolidated corporation income and excess profits tax return for the calendar year 1936 the Carriers' Excise Taxes imposed upon it by the Carriers' Taxing Act of 1935 and aggregating $2,525,543.91, which were not paid but were actually accrued on its books of account and on the books of its three subsidiaries from March 1 through December 31, 1936.

V.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

A. In holding that the fact of contest of a liability by suit is alone a sufficient manifestation of contingency, the Court of Appeals has misinterpreted *Dixie Pine Co. v. Commissioner* (320 U.S. 516) and *Security Flour Mills Co. v. Commissioner* (321 U.S. 281) and has failed to give proper effect to the principles of law established by this Court in the line of cases beginning with *United States v. Anderson* (269 U.S. 422).

B. In holding that contest of a liability for tax on the ground of its constitutionality is alone sufficient to deprive the taxpayer of the right to accrue and deduct the amount of the tax on its Federal income tax return, the Court of Appeals has decided a question of importance in the administration of the Internal Revenue law which has not been, but should be, settled by this Court.

WHEREFORE, your Petitioner prays that a Writ of Certiorari issue under the seal of this Court, directed to the United States Court of Appeals for the Fourth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings the said Court of Appeals had in the case numbered and entitled on its docket No. 5870, *The Baltimore and Ohio Railroad Company, Appellant, vs. M. Hampton Magruder, Collector of Internal Revenue, District of Maryland, Appellee,* to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States and that the judgment herein of said Court of Appeals be reversed by this Court, and for such other relief as to this Court may seem proper.

THE BALTIMORE AND OHIO RAILROAD COMPANY,
Petitioner,

By: JOHN S. STANLEY,

D. HEYWARD HAMILTON, JR.,
Counsel for Petitioner.

Dated August 11, 1949.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

OPINIONS OF COURTS BELOW

The opinion of the Court of Appeals has not been reported but will be found at pages 110-115 of the Record and the opinion of the District Court in 77 F. Supp. 156.

II.

JURISDICTION

The date of the judgment of the Court of Appeals to be reviewed is May 24, 1949. The Petition for Writ of Certiorari was filed August 11, 1949. The statutory provisions which are believed to sustain the jurisdiction of this Court are Sections 1254 (1) and 2101 (c) of Title 28 of the United States Code (c. 646, 80th Congress, 2d Session—Public Law 773). The Court of Appeals has misinterpreted the opinions of this Court in *Dixie Pine Co. v. Commissioner* (320 U.S. 516) and *Security Flour Mills Co. v. Commissioner* (321 U.S. 281) and has failed to give proper effect to the principles of law established in a line of cases beginning with *United States v. Anderson* (269 U.S. 422) and has decided a question of importance in the administration of the Internal Revenue law which has not been but which should be settled by this Court (Supreme Court Rule 38 (5) (b)).

III.

STATEMENT OF THE CASE

The case has already been stated in the Petition for the Writ under Part I (pp. 1-5), which statement is hereby adopted and made a part of this Brief.

IV.

SPECIFICATION OF ERRORS

The Court of Appeals erred in holding that under Section 23 (c) of the Revenue Act of 1936 a taxpayer, which did not pay but bona fide accrued in 1936 on its books the Carriers' Excise Tax imposed by the Taxing Act of 1935, may not lawfully take as a deduction on its Federal income tax return for that year the amount of the taxes so accrued for the sole reason that it joined in a suit attacking the constitutionality of said Carriers' Taxing Act and that, therefore, the disallowance of said deduction and the denial of the Petitioner's claim for refund of taxes paid as a result of said disallowance were proper.

V.

ARGUMENT

A.

IN HOLDING THAT THE FACT OF CONTEST OF A LIABILITY BY SUIT IS ALONE A SUFFICIENT MANIFESTATION OF CONTINGENCY, THE COURT OF APPEALS HAS MISINTERPRETED *DIXIE PINE CO. V. COMMISSIONER* AND *SECURITY FLOUR MILLS CO. V. COMMISSIONER* AND HAS FAILED TO GIVE PROPER EFFECT TO THE PRINCIPLES OF LAW ESTABLISHED BY THIS COURT IN THE LINE OF CASES BEGINNING WITH *UNITED STATES V. ANDERSON*.

In affirming the District Court, the Court of Appeals has in effect held that the Petitioner's joining in the suit brought by one hundred and thirty-seven other railroads to have the Carriers' Taxing Act of 1935 held unconstitutional was alone sufficient to make the liability for such taxes contingent and thus to deprive it of its right to accrue and deduct them from its gross income for that year. In other words, the Court agreed with the Respondent that this Court held in *Dixie Pine Co. v. Commissioner, supra*, that the sole fact of contest by suit of liability for taxes is

sufficient evidence of the contingency of such liability and that, being contingent, they may not be deducted.

The Petitioner contends that that is an incorrect interpretation of the opinion of this Court and that the case presented by the record at bar has never been decided by this Court and is not controlled by either one of its decisions cited by the Court of Appeals. It is the position of the Petitioner that the opinion of this Court in the Dixie Pine case must mean (in the light of the facts of that case and of the decisions cited in support of the conclusion reached) that in every case of this kind it must be found that a liability (sought to be deducted on an income tax return), whether arising out of imposition of tax, breach of contract or otherwise, is not fixed or certain and that the fact of contest, whether by suit or otherwise, will be some evidence, but not all, of such uncertainty. As admitted by the Court of Appeals in its opinion in the case at bar, "Conceivably the contingent nature of a liability may be manifested by other circumstances" than a contest thereof by the taxpayer. In the Dixie Pine case, in addition to contest by suit, the contingent nature of the liability for the tax was manifested by other circumstances and, therefore, this Court did not hold that such contest alone was a sufficient manifestation of the contingent nature of the liability for the tax. It is true that in that case there was at all times a contest of liability in a suit by the taxpayer. Other circumstances were, however, present.

The first of these was the fact that the taxing official of the State of Mississippi advised the Dixie Pine Company "that he was uncertain whether the tax was due for the use of the solvent and that the determination of liability was then dependent upon the final decision of the court." See the Board's Findings of Fact in the case (45 B. T. A. 286, 288), page 3 of the Government's Brief in Opposition to the

Petition for Certiorari and page 4 of its Brief on the Merits. Thus, in that case the State itself was admittedly under grave uncertainty as to whether there was any liability for the tax in 1937.

The second was that in the Dixie Pine case no accrual of the tax liability was in fact made in the ordinary course of business during 1937 or in accordance with well established accounting practice. In this way the taxpayer indicated that it did not actually believe that it was subject to any liability whatsoever during the year or that the taxes involved were the proper subject of bona fide accruals. This was recognized as one of the significant facts on the issue of contingency in *Lucas v. American Code Co.* (280 U. S. 445). As a matter of fact, the bookkeeping of the year's liability for the taxes was handled in the form of a closing entry as of the end of the tax year on the advice of counsel and was actually put on the books between January 1 and March 15 of the following year. In other words, the manner in which the item was treated manifested that the taxpayer did not believe the item properly accruable.

The third was that the taxpayer denied, at all times throughout the tax year, that the tax statute of Mississippi was applicable to it; and at the beginning of the tax year involved the highest court of Mississippi decided the contest in favor of the taxpayer not on the ground that the taxing statute was invalid for any reason but on the ground that it did not apply to the taxpayer at all, since its solvent was not gasoline within the statutory definition of the word. The taxpayer, believing that no tax was due, ceased and refused to pay.

The fourth distinction between these two cases is that in the Dixie Pine case the action of the taxpayer, in assert-

ing in the litigation instituted by it that it was not embraced within the terms of the taxing statute, was the sole cause of its exoneration from liability, whereas the joinder of the Petitioner together with one hundred and thirty-seven other railroads in the test case, raising the question of the constitutionality of the Carriers' Taxing Act of 1935, in no way affected its liability. If, for instance, it had decided to remain out of the case and if in its place and stead the Curtis Bay Railroad (one of the railroads whose income was reported in the joint return filed by the Petitioner) had become one of the parties plaintiff, the liability of the Petitioner under the Carriers' Taxing Act, whatever may have been the final action of the courts, would have been precisely the same as if (as was actually the case) the Petitioner had become a party and the Curtis Bay Railroad, by inadvertence, had been omitted as one of the many parties thereto. In other words, the circumstance of whether or not the Petitioner was a party to the case could in no conceivable way have affected its tax liability whatever the decision of the Court upon the question of the constitutionality of the statute.

It was because of the presence of these facts in the record in the case that Mr. Justice Roberts said that the taxpayer must "in the circumstances" await the event of the State court litigation. After repeating the general rule that in order truly to reflect the income of a given year all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted but not paid, the Justice said that "this cannot be the case where the liability is contingent *and* is contested by the taxpayer." (Italics supplied). Finally, he relied on decisions of the Board of Tax Appeals to the same effect in numerous cases and on earlier rulings as to proper tax accounting practice and concluded that, as

the Board applied the correct rule of law, its determination was entitled to the finality indicated by *Dobson v. Helvering* (320 U. S. 489).

From this analysis of the Court's opinion in the Dixie Pine case, it is clear that it was moved by consideration of the following facts: (1) at the beginning of the tax year the official of the State, charged with the collection of the tax, had declared that he was uncertain as to whether the statute applied to the taxpayer and hence whether the tax was payable; (2) the taxpayer denied all liability for the tax because the solvent used by it was not within the meaning of gasoline as defined in the statute; (3) the taxpayer indicated that it did not believe the liability for the tax really accrued in the tax year because it did not enter it as an accrual on its books; and (4) the Court relied on the doctrine of the Dobson case to the effect that the views of the Board of Tax Appeals or the Tax Court as to proper accounting practice will not be overthrown, so long as the correct rule of law is applied.

In the case at bar, with the exception of the pendency of the suit, none of these indicia of contingency is present. First, instead of expressing doubts as to the Petitioner's liability for the tax, the Commissioner of Internal Revenue and the Collector at all times in 1936 took the position that the tax was due by promptly appealing the adverse decision of the District Court in the District of Columbia holding the Carriers' Taxing Act of 1935 unconstitutional and void. Thus, the Commissioner, whose duty under the statute was to collect the tax, asserted its validity throughout 1936.

Second, accruals of the Carriers' Excise Taxes were made in the Petitioner's books regularly as every month of 1936 went by after the Act took effect. The Act itself laid the taxes upon the monthly wages paid and the Peti-

tioner and its subsidiaries accrued the taxes monthly. Such accruals were made in accounts designated to indicate their particular nature and set up in accordance with the requirements of the uniform system of accounting of the I. C. C. These accruals were made bona fide and not purely as a matter of accounting expediency resorted to as an afterthought for the purpose of taking advantage of the Revenue Law. In entering them, the Petitioner was obeying a regulation of the Federal Government which controlled its every fiscal operation. The fact of this regular course of accruing these taxes signifies that the Petitioner, even though it had become a party to the suit contesting the constitutionality of the tax, regarded the liability as certain and unquestionable and, for tax accounting purposes, free of all contingency. In other words, the regular accruals so made were a sure indication that the Petitioner really thought that it was under liability for these taxes. As Mr. Justice Roberts said in the Dixie case, "a taxpayer who accounts on the accrual basis may, and should, deduct from gross income a liability which really accrues in the taxable year."

Third, the Petitioner did not deny that the Carriers' Taxing Act of 1935 was not in terms applicable to it. On the contrary, it joined in the complaint of the other carriers in the District Court in stating that they were all subject to the operation of the Act, provided it was valid. The only question raised by the complaint was the Act's constitutionality.

In addition, however, to the presence of such indicia of certainty of liability, there are four additional factors present in this case which were absent in the Dixie Pine case. In the present case, the final decree of the District Court gave effect to the continued existence of the tax liability

by directing the carriers to hold sums, collected by them from their employees by deduction from their compensation, in special accounts subject to the order of the Court and to make reports of the amounts, so held, quarterly to the Court, beginning with the first quarter as of March 31, 1936. The amendment of this decree, made on July 1, 1936, provided that nothing in the original decree should be construed to forbid any of the Plaintiff carriers from paying to the Commissioner of Internal Revenue the sums deducted from the wages of their employees. The decree, as so amended, thus acknowledged that, insofar as the liability of the carriers to collect the tax on their employees was concerned, it was continuing and certain. This being the case, it must follow that the coordinate and co-extensive liability for a tax in equal amount imposed by the Act on the carriers themselves did likewise continue in effect and remain certain and fixed.

Moreover, one day before the Act of 1935 was to expire by its terms, Congress adopted its Joint Resolution No. 9 on February 27, 1937, extending the termination date of the Act to June 30, 1938, and thereby concurred with Mr. Justice Bailey in the District Court for the District of Columbia in treating the Act of 1935 as still in force and effect and as remaining so until final adjudication should be had. This decree of the Court and this Resolution of the Congress gave recognition to the doctrine of this Court announced in *Chicot County Drainage District v. Baxter State Bank et al.* (308 U. S. 371). This action of the Congress occurred about two weeks before the consolidated income tax return of the Petitioner was filed with the Collector.

About three months and a half after the return was filed Congress again treated the Act of 1935 as being then in

force and effect for on June 29, 1937, it enacted the Carriers' Taxing Act of 1937, which according to its express terms was substituted for the Act of 1935. When, by Section 11, the second Act provided that all moneys payable as and for taxes under the first Act and not theretofore paid should cease to be payable, it surely indicated an admission by Congress that a liability for such taxes still existed under the first Act and that neither the suit of the carriers nor the opinion and decree of Mr. Justice Bailey had extinguished that liability. If no liability for the taxes under the Act of 1935 had survived the litigation and the resultant decree of the District Court, there would have been no necessity whatever for the inclusion of such a provision in the Act of 1937. By the second Act, Congress in effect confirmed the certainty of liability of carriers covered by the first Act.

Lastly, by its final decree, entered July 2, 1937, upon the carriers' Joint Motion to Reverse and Remand as Moot, the Court of Appeals of the District of Columbia reversed the decree of the District Court holding the Act of 1935 unconstitutional and void and directed that their complaint be dismissed. It was dismissed as moot. Such reversal and dismissal took place, not because the Court of Appeals had heard argument and decided the question of constitutionality on its merits in favor of the validity of the Act, but because Congress itself had supplanted the Act with another statute.

For all of these reasons we submit that the Court of Appeals has not only misinterpreted the Dixie Pine case but has also incorrectly extended the true decision therein made.

We believe that the Court of Appeals has not only misinterpreted the facts of the Dixie Pine case but also the

language of the opinion. The Respondent argued that what Mr. Justice Roberts said was that all the events must occur in the taxable year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted but not paid and that this could not be the case where the liability is contingent *in that* it is contested by the taxpayer. That is not, however, the language of the opinion. What Mr. Justice Roberts did say was that "where the liability *is contingent and* is contested by the taxpayer" in the taxable year, all the events which fix the liability do not occur within the year and the tax cannot be deducted (Italics supplied). If he had meant to do what the Collector says he has done, there would have been no necessity for the italicized phrase. If that had been his meaning, he need only to have written that "If the taxpayer contests, in court or otherwise, the liability under a taxing statute or any other liability under any other kind of obligation, he may not accrue and deduct." That could not have been his meaning because what he said in effect was that "A taxpayer may not accrue and deduct when the liability is contingent and he contests it." The Collector would ignore the effect of the conjunctive "and" and substitute in its place the subjunctive "if", but the use of the phrase "where the liability is contingent and" must have had some purpose. The purpose is revealed, we believe, by the nature of the decisions of this Court cited in support of this and other closely related parts of the opinion.

As authority for the statement about contingency, *Lucas v. American Code Co., supra,* was cited. It is true in that case the taxpayer denied liability for a breach of contract and defended a suit against it therefor but in its opinion this Court expressly referred to the fact that the taxpayer did not accrue on its books the liability for the breach sought to be deducted on its income tax return and pointed

out that the liability might have been reduced or totally defeated by the death of the other party to the contract and also that he might recover on account of the breach, if there was legal liability, depending in large measure on the course of future events. In this case the Court said, at page 451:

> "In the case at bar the contract had nearly eighteen more years to run at the time of its breach. Liability for the breach was denied and strenuously contested, the litigation being carried to the highest court of the state. The amount of the damages, if any, was wholly unpredictable. While the facts determining liability had occurred in the year of the breach, the amount to be recovered, if there was legal liability, depended in large part on the course of future events. Farquhar was under a duty to mitigate damages. He might have procured new employment which would have reduced his recovery to a nominal amount. Or, recovery might have been reduced or defeated by his death. Finally, the company did not accrue on its books, within the tax year, a liability in the estimated amount of the loss. The reserve set up had no relation to the apprehended total loss. It constituted simply the amount of the commissions which would have been payable in that year if Farquhar had remained in the company's employ. That the company did not intend the reserve to be an accrual of the total estimated loss is clearly indicated by the fact that in 1920 it charged to the reserve, to cover the commissions which would have been payable in 1920, an additional amount, more than double that charged in 1919."

There could have been nothing more indefinite, speculative or uncertain than the fact and amount of the liability of the American Code Company to its salesman, Farquhar.

Of the seven cases cited by Mr. Justice Roberts *Lucas v. American Code Co.* is the only one which involved a contest of liability by suit. In the other six there was neither

denial nor contest of liability by the taxpayer. In five other cases cited, this Court held in two (Anderson and Routzahn cases) that a liability for the tax on munitions imposed by statute in 1916 but payable in 1917 was properly accruable and deductible in the earlier year. In one of the others (the Continental Tie and Lumber Company case) the Court held that the right of compensation under the Transportation Act of 1920 came due and was definite and certain in the year of the enactment thereof and was not to be accrued and deducted from the income of a later year in which the final award was actually made under the Act by the Interstate Commerce Commission. The facts of the other two cases (the Niles Bement Pond and the Brown cases) had no real similarity to the Dixie Pine case and were evidently referred to, along with the others, as indicating the development of the principle governing the deductibility of accruals as originally stated in *U. S. v. Anderson, supra.*

Mr. Justice Roberts' conclusion in the Dixie Pine opinion is that "in the circumstances" of that case the taxpayer must "await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability was finally adjudicated." In this connection he refers to *Brown v. Helvering* (291 U. S. 193). In that case, however, there was no contest and the Court held that the liability of a general insurance agent, arising from expected future cancellations of policies already written, was not deductible because it could not be known that any particular policy written within the tax year or that a definite percentage of all the policies so written would be cancelled in the future, and hence the liability was clearly not fixed and absolute.

The fact that this Court was not content to rest the Dixie Pine case upon the Lucas case alone, but cited as well six other cases, in which there was no contest of

liability but in which other indicia of uncertainty were present, signifies that the Court did not intend to hold that the mere fact of a contest of liability by suit is sufficient to invalidate an accrual otherwise valid. Because of this fact, we believe that the correct interpretation of the opinion is that in each case the Tax Court or other court must find from the facts in the record that the liability, whether arising out of imposition of tax, breach of contract or otherwise, is not fixed or certain and that the fact of contest by suit will be some evidence, but not all, of such uncertainty. We think that in the Dixie Pine case this Court has decided that contest by the taxpayer by suit against the Collector is *one* of the facts that makes tax liability contingent and we believe that the Court of Appeals has gone one step further and held that contest by suit is the *only* fact that makes the liability contingent.

The Collector and the Court of Appeals seem to have anticipated this weakness in reliance on the Dixie Pine decision because it is said that this principle was re-affirmed by this Court in the Security Flour Mills case. But a painstaking analysis of the Transcript of the Record will not bear out this conclusion. There, the taxpayer sold its flour at a price with "the tax on" but not separately indicated. In January 1 to May 1 of the tax year involved, 1935, it paid the processing taxes on the flour so sold. In June of that year it filed a suit to enjoin the collection of the tax, and an injunction was issued on condition that the taxpayer pay to a depository appointed by the Court the amount of the taxes on its sales made after May 1. The sum of about $90,000, equivalent to the tax on the sales made between May 1 and November 30, was paid by the taxpayer to the depository, but no sum was paid on the sales made in December, for on January 6, 1936, the taxing provision of the Agricultural Adjustment Act was held unconstitutional

by the Supreme Court. Nevertheless, the taxpayer accrued over $9,000 on its books as taxes payable on the sales for December and also $1,000 as a reserve for possible increase in the amount paid into the depository. After the Act was held unconstitutional, some of the taxpayer's vendees filed suits for reimbursement of impounded moneys, consisting of that part of the price of the flour sold them that represented the taxes thereon. The taxpayer resisted these suits and the District Court dismissed them and directed repayment to it of the impounded money. It set up on its books a suspense account covering these items under the title "Reserve for Processing Taxes, Claims, etc." and in 1936, 1937 and 1938 voluntarily refunded to its customers over $45,000 for processing taxes included in the sales price of flour sold them in 1935 and not actually paid to the Collector of Internal Revenue. The taxpayer did not accrue in 1935 as a liability the claims of its vendees for reimbursement and no such deduction was made in its return for 1935. In its income tax return for 1935 the taxpayer deducted as accrued tax liability the total of the amounts impounded and accrued but not paid the Collector. In 1937 the Commissioner of Internal Revenue disallowed this deduction and the additional claim, then made, for deduction of the total repaid to customers and found a deficiency.

The taxpayer claimed that under a proper construction of Sections 23 (a), 41 and 43 of the Revenue Act of 1934, the sums reimbursed to its customers in 1936, 1937 and 1938 were deductible from gross income in 1935 and should be allowed for that year by virtue of the concluding clause of Section 43 which, it argued, authorized and required the Commissioner to allow deductions to be taken as of a different period than the tax year wherever, on analysis of any transaction extending over more than one tax year,

he should find that it would be unjust or unfair not to treat the transaction on the basis of a long term result.

The Court held that this was not the purpose of that clause but that its true purpose was "to take care of fixed liabilities payable in fixed installments over a series of years" like rent and that "it was not intended to upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer." Thus, the real decision in this case is that Section 43 did not permit in 1935, under Section 23 (a), deductions of business expenses actually paid in 1936, 1937 and 1938. An examination of the Petition of Certiorari and of all the Briefs, both on the Petition and on the Merits, discloses that this was the primary question before the Court. It is important to note that there is no reference in the Petition for Certiorari or any of the Briefs to the deductibility, by virtue of Section 23 (c), of the processing taxes which were accrued in 1935, although they were actually deducted. On page 9 of its Brief on the Merits the taxpayer argued that if the Commissioner was permitted to reopen in 1937 its income tax return for the calendar year 1935 and disallow the deduction of the processing taxes accrued in the earlier year, "Justice requires his reopening the year for all purposes and permitting petitioner to substitute the vendee reimbursements for the tax deduction." See also pages 41 and 57 of this same Brief.

If this analysis of this case is correct, it must follow that the effect of contest by suit upon the accruability of taxes under Section 23 (c) was not actually before the Court for decision and hence it is not a binding and conclusive precedent in the case at bar.

B.

THE COURT OF APPEALS HAS DECIDED A QUESTION OF IMPORTANCE IN THE ADMINISTRATION OF THE INTERNAL REVENUE LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

We believe that a large part of the argument set forth in Part A of this Brief demonstrates that, in reaching the conclusion that contest by suit of a liability for tax is alone sufficient to deprive the Petitioner of the right to accrue and deduct the amount of the Carriers' Excise Tax on its Federal income tax return, the Court of Appeals has decided a question which has not been settled by this Court. If our interpretation of the decision in the Dixie Pine case is the true one, this must necessarily follow.

In addition to this, there are other reasons why this question is one of importance in the administration of the Internal Revenue law which should be set at rest. In cases involving the administration of such laws the Court should be concerned with the consequences which might flow from adoption of a new doctrine, whether it be by one or more Courts of Appeals and whether their view be in conflict or unanimous. If the decision of the Court of Appeals in this case is correct, its effect will be far reaching and incalculable.

The notion that the right to accrue a liability for taxes may rest entirely within the control of the taxpayer will, if adopted, lead to all manner of abuse and confusion. Off hand, if the Respondent's contention and the lower Courts'

decisions are sound, it would seem that the taxpayer may for any reason sufficient unto itself contest the liability for taxes and thus throw into a future tax year, to its own advantage, the deduction of the amount so contested. As wisely pointed out by the Court in *Atlanta, B. & C. R. Co. v. Forrester* (25 S. E. (2d) 581), "Whether the tax was due or not could not be affected by any attitude or contention of the taxpayer." and "To allow a taxpayer to fix his own date of accrual on the basis of his admission of liability would wreak havoc with the law." Contingency ought to be determinable with regard to all the facts and not with sole regard to the action or attitude of the taxpayer.

To permit a taxpayer to postpone an accrual to a future year merely by contesting his liability for the tax in the year in which it arises will run directly contrary to the purpose of the Congress in requiring income taxes to be returned and paid on the basis of annual accounting. This purpose was recognized by Mr. Justice Stone in *Burnet v. Sanford & B. Co.* (282 U. S. 359) where he said:

> "All the revenue acts which have been enacted since adoption of the 16th Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.
>
> * * * * * *
>
> "* * * It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation."

So all-pervading and fundamental is this purpose that fear of running into conflict with it moved the Supreme Court to restrict the effect of Section 43 of the Revenue Act of 1934 by refusing to permit deductions of expenses (except those of a few limited categories) to be taken in a period different from that in which they were incurred. In support of this decision in the Security Flour Mills case, Mr. Justice Roberts cited the above quoted portions of Mr. Justice Stone's opinion as well as six earlier decisions of the Supreme Court in which the principle had "often been stated and applied". As he pointed out, the result of this application has been to deny both the Government and the taxpayer "the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount."

In the face of these repeated declarations of this Court, the Respondent would have it confirm the view of the Court of Appeals in deciding that, notwithstanding a liability for taxes may arise in one year and be in every respect certain and fixed and so properly accruable in that year, the taxpayer may contest his liability therefor and may thus obstruct the regular flow of income for which the system of taxation adopted by Congress is designed. Both as a matter of logic and practical application of the law it would be more consistent with the theory of the Security Flour Mills opinion and those cited therein, to permit the taxpayer to accrue the taxes, the validity of which is being contested by litigation, during the year that such taxes become due rather than to postpone the accrual until the litigation is finally terminated. The time of such final termination may be, and often is, many years after suit has

been begun and, obviously, deduction then of a liability for taxes which arose many years before can have no possible relation to the production of income in the year of accrual. All of this is contrary to the theory of income tax accounting as expounded by Mr. Justice Stone in *U. S. v. Anderson, supra;* and, if the holding of the Dixie Pine and Security Flour Mills cases is to be carried to such length in every case of contest of tax liability, the taxpayer will be free to pick the year, in which deduction for the taxes must be taken, merely by contesting his liability therefor. The result will be to permit him to thwart a basic purpose of the Internal Revenue law and to secure a tax advantage by his own act. This Court has many times said that the Revenue Acts were drawn to prevent this very possibility.

Such a result was foreseen by the Respondent when, in the last sentence of his argument on page 16 of his Brief in the Court of Appeals, he says that "Indeed, the process can very conceivably have worked to the advantage of the contesting parties, depending upon their income in the various years involved." The Respondent thus expressly recognized the danger involved in his position; and to appreciate that danger it is hardly necessary to enumerate the many ways in which a taxpayer conceivably could use such a doctrine to his own advantage.

But, aside from all these considerations, we believe that the adoption of a single test of contest will bring confusion worse confounded into the administration of the Internal Revenue laws. In the first place, how is a contest to be defined? Must it be a contest by litigation or is a mere denial of liability, made known to the tax collector, sufficient? Merely these two questions give some intimation of the practical difficulties on that score.

In the second place, it may be suggested that the ability of the taxpayer to obtain a tax advantage by contesting

liability may be limited by imposing the requirement that the contest be bona fide. But it is by no means clear what tests, if any, would be efficient and practical for the determination of the issue of good faith. Even if practical tests could be evolved and were applied, what would be the result if the contest were found to be mala fide? Would a lack of good faith in contesting the liability mean that the accrual and deduction of the item would not be postponed until the litigation were ended or that it would have to be made in the year that contest were begun? Or, would some other method of treatment be used? It is not an exaggeration to say that, if the Court of Appeals is correct in its decision, in every case where a liability for tax is contested the Commissioner may find himself called upon to decide whether the contest is bona fide or mala fide.

All these matters suggest the importance of a final determination by this Court of the validity of the position now taken by the Respondent and confirmed by the Court of Appeals.

VI.

CONCLUSION

For the reasons set forth in the Petition for the Writ and in this Brief this Court should grant the Writ for the purpose of reviewing the decree of the Court of Appeals for the Fourth Circuit.

Respectfully submitted,

JOHN S. STANLEY,

D. HEYWARD HAMILTON, JR.,
Counsel for Petitioner.